

BEFORE THE TENNESSEE STATE BOARD OF EQUALIZATION

IN RE: National Bank of Commerce)
 Custodian for G. Blair Macdonald IRA) Shelby County
 Dist. A01, Block 41, Parcel 0152)
 Industrial Property)
 Tax Years 2005 & 2006)

INITIAL DECISION AND ORDER

Statement of the Case

The subject property is presently valued as follows:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$174,000	\$616,400	\$790,400	\$316,160

An appeal has been filed on behalf of the property owner with the State Board of Equalization. The undersigned administrative judge conducted a hearing in this matter on February 28, 2007 in Memphis, Tennessee. In attendance at the hearing were G. Blair Macdonald, the appellant, Eric A. Trotz, MAI, and Shelby County Property Assessor's representative Rick Middleton, TCA.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Subject property consists of a 50,000 square foot distribution warehouse constructed in 1975 located at 11531 Gulf Stream Drive in Arlington, Tennessee. The taxpayer purchased subject property in 1992 for \$400,000.

Subject property is presently leased for a fixed minimum rent of \$9,375 per month (\$112,500 annually) pursuant to a lease which commenced on January 1, 1996 and ends on December 31, 2005. Mr. Macdonald testified that in December of 2004 the tenant advised him it planned to vacate the property in 2006. Although the tenant has not yet actually vacated the property, Mr. Macdonald testified that on the relevant assessment date of January 1, 2005 he assumed the lessee would be vacating the property within approximately one year.¹

The taxpayer contended that subject property should be valued at \$483,000 - \$537,545. In support of this position, Mr. Macdonald introduced an income approach (exhibit #1) which he maintained supports a maximum value indication of \$537,545.

Mr. Macdonald also argued that subject property experiences a loss in value and higher than normal expenses because of four distinct problems. First, moisture under the sealer and paint causes parts of the block to come off and must be addressed periodically by

¹ The parties have agreed to consolidate tax years 2005 and 2006. The value adopted for tax year 2005 (the reappraisal year) will simply be carried forward by the administrative judge for tax year 2006.

filling the holes, resealing and repainting. Second, subject property has four (4) inch floors rather than the typical six (6) inch thickness found in similar properties. The floor thickness limits fork lift loads, limits the stack height for many products to twelve (12) feet and results in additional maintenance. Third, the fork lift loading of trailers is limited by a 5.5 degree upslope from the truck wells which is higher than the interstate highway standard. Fourth, the low capacity "ordinary hazard group 1" sprinkler system limits the stack height for most products to twelve (12) feet high and would cost approximately \$125,000 to cure.

Mr. Macdonald maintained that the foregoing problems severely limit the number of occupants that can economically use the property.

The taxpayer also introduced into evidence the testimony and analysis of Eric A. Trotz, MAI. Mr. Trotz placed primary emphasis on the income approach (exhibit #2) which he asserted supports a value indication of \$483,000. In addition, Mr. Trotz's analysis included several comparable sales which he argued bracket his conclusion of value via the income approach.

The assessor contended that subject property should be valued at \$754,400. In support of this position, Mr. Middleton introduced cost, sales comparison and income approaches he asserted support value indications of \$799,300, \$1,000,000 and \$754,400 respectively. Mr. Middleton gave greatest weight to the income approach and recommended a value of \$754,400.

The basis of valuation as stated in Tennessee Code Annotated Section 67-5-601(a) is that "[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values . . ."

General appraisal principles require that the market, cost and income approaches to value be used whenever possible. Appraisal Institute, *The Appraisal of Real Estate* at 50 and 62. (12th ed. 2001). However, certain approaches to value may be more meaningful than others with respect to a specific type of property and such is noted in the correlation of value indicators to determine the final value estimate. The value indicators must be judged in three categories: (1) the amount and reliability of the data collected in each approach; (2) the inherent strengths and weaknesses of each approach; and (3) the relevance of each approach to the subject of the appraisal. *Id.* at 597-603.

The value to be determined in the present case is market value. A generally accepted definition of market value for ad valorem tax purposes is that it is the most probable price expressed in terms of money that a property would bring if exposed for sale in the open market in an arm's length transaction between a willing seller and a willing buyer, both of

whom are knowledgeable concerning all the uses to which it is adapted and for which it is capable of being used. *Id.* at 21-22.

After having reviewed all the evidence in the case, the administrative judge finds that the subject property should be valued at \$611,000 in accordance with the following income approach:

Potential Gross Income		\$112,500
Less Vacancy & Credit Loss (10%)	-	<u>11,250</u>
Effective Gross Income		\$101,250
Plus Other Income	+	<u>3,930</u>
Total Effective Gross Income		\$105,180
Less Operating Expenses	-	<u>20,000</u>
Net Operating Income (NOI)		\$ 85,180
NOI Capitalized @13.94%	÷	<u>.1394</u>
Indicated Value Before Rounding		\$611,047
Adopted Value		\$611,000

The administrative judge finds that the parties' proposed rental rates of \$2.25 and \$2.50 per square foot do not differ dramatically and are actually mutually supportive insofar as Mr. Middleton's "model" initially assumes a base income rate of \$3.25 per square foot. The administrative judge finds that the somewhat lower rate proposed by the taxpayer should receive greater weight due to both the market vacancy rate on January 1, 2005, and the lessee's notice in December of 2004 that it planned to vacate the property in 2006.

The administrative judge finds that a 10% vacancy and credit loss should be adopted in accordance with both parties' income approaches.

The administrative judge finds that other income equal to \$3,930 should be assumed in accordance with Mr. Trotz's income approach. The administrative judge finds that Mr. Middleton did not consider the tenant reimbursement for insurance in his income approach.

The administrative judge finds that the primary difference between the parties' income approaches concerned operating expenses. Mr. Middleton assumed operating expenses of 30¢ per square foot whereas Mr. Macdonald and Mr. Trotz assumed operating expenses equal to 95¢ and 85¢ per square foot respectively. Both Mr. Macdonald and Mr. Trotz relied in large part on subject property's actual operating history from 1994-2004. The parties' significantly different estimates were compounded by the fact that Mr. Middleton accounted for leasing commissions in his capitalization rate rather than as an expense item.

Respectfully, the administrative judge finds that the actual expense history of subject property from 1994-2004 cannot simply be averaged in order to arrive at a stabilized estimate. The administrative judge finds that actual operating expenses have fluctuated

wildly from year to year as summarized in attachment D to exhibit #2. The administrative judge finds that capital expenditures and other atypical expenses are unquestionably included in certain years.

The administrative judge finds that just as the taxpayer's analysis overstates stabilized expenses, Mr. Middleton's income approach somewhat understates stabilized operating expenses *for subject property*. The administrative judge finds that the previously summarized testimony of Mr. Macdonald supports adoption of stabilized operating expenses equal to 40¢ per square foot or \$20,000.

The administrative judge finds that both Mr. Trotz and Mr. Middleton assumed loaded capitalization rates of 12.94% in their pro formas. However, Mr. Trotz accounted for leasing commissions in his expense estimate whereas Mr. Middleton maintained that the base capitalization rate of 11% included leasing commissions. The administrative judge finds that by relying on subject property's actual expense history from 1994-2004 Mr. Trotz effectively accounted for various items in his expense allowance that Mr. Middleton implicitly accounts for in his capitalization rate.

The administrative judge finds Mr. Macdonald's unrefuted testimony established that the lessee gave notice in December of 2004 that it would be vacating the property in 2006. The administrative judge finds that a potential buyer of subject property on the relevant assessment date of January 1, 2005 would almost certainly require an additional return to account for this element of risk. The administrative judge finds the associated risk of finding a new lessee (or multiple lessees) is compounded by the deficiencies previously summarized. Taken as a whole, the administrative judge finds that the preponderance of the evidence supports adoption of a loaded capitalization rate of 13.94%.

The administrative judge finds that the parties' sales comparison approaches lack significant probative value. Indeed, neither party placed significant weight on the sales comparison approach.

The administrative judge finds that the cross-examination of both appraisers established significant problems with the various comparables. For example, the three comparables relied on by Mr. Middleton contained as little as 15,000 square feet and a maximum of 34,640 square feet. On the other hand, Mr. Trotz did not adjust his sales and appears to have relied on one sale between related parties (Sandusky Cabinets, Inc. to Edsal Sandusky Corp.) as well as a distressed sale (McInnes Steel Co. to Thunderbird of Tennessee, LLC).

ORDER

It is therefore ORDERED that the following value and assessment be adopted for tax years 2005 and 2006:

<u>LAND VALUE</u>	<u>IMPROVEMENT VALUE</u>	<u>TOTAL VALUE</u>	<u>ASSESSMENT</u>
\$174,000	\$437,000	\$611,000	\$244,400

It is FURTHER ORDERED that any applicable hearing costs be assessed pursuant to Tenn. Code Ann. § 67-5-1501(d) and State Board of Equalization Rule 0600-1-.17.

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **“must be filed within thirty (30) days from the date the initial decision is sent.”** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review; or
3. A party may petition for a stay of effectiveness of this decision and order pursuant to Tenn. Code Ann. § 4-5-316 within seven (7) days of the entry of the order.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 19th day of March, 2007.



 MARK J. MINSKY
 ADMINISTRATIVE JUDGE
 TENNESSEE DEPARTMENT OF STATE
 ADMINISTRATIVE PROCEDURES DIVISION

c: Mr. G. Blair Macdonald
Tameaka Stanton-Riley, Appeals Manager